Building a Successful Strategic Alliance between IOCs and NOCs

National oil companies (NOCs) are organizations that are relatively more concerned about their home countries than IOCs, which are majority owned by the governments of their home countries. NOCs operate in favor of their home countries’ interest as they provide their governments with pay revenues, taxes, and royalties. They also create job opportunities and they contribute to local social responsibility projects. NOCs are, accordingly, affected by the political and social environment of their home countries. State-owned oil companies are currently holding the acquisition of the vast majority of the world’s hydrocarbon resources.

Meanwhile, International Oil Companies (IOCs) are considered to be some of the largest and most significant economic organizations worldwide, due to their long years of experience in the oil and gas field, and their involvement in the upstream, midstream, and downstream operations of the oil and gas industry. Whether on their own or together, they hold large amounts of capital that they have been collecting over the years. They are the biggest operators in the oil and gas industry due to their high competence, technological advancement, and their ability to handle big risk projects and generate greater profit through their marketing distribution channels and their powerful brands that are now considered to be global trademarks.

IOCs bring access to risk capital, technical expertise, and diverse assets, and an ability to build relationships with customers worldwide through their refining and marketing activities and strong brands that transcend national boundaries.” said BP Former Chief Executive Officer, Tony Hayward, in the book titled - “The Changing Relationship Between IOCs and NOCs by David Ledesma.”

In the 1770s, IOCs were in control of the oil and gas market globally; as they used to own around 90% of the reserves and they were responsible for 75% of the overall oil production. However, the oil and gas market drastically changed over the last decades. Currently, the IOCs hold less than 20% of global reserves and their production has been decreasing since the 1990s. On the other hand, NOCs are responsible for 75% of the global oil production and they hold 90% of proven oil reserves, according to data obtained by the World Bank in 2010. In the last decade, the importance of the NOCs, in comparison to the IOCs, has risen due to their domination over global reserves.

The current situation brings challenges to both IOCs and NOCs. On one hand, IOCs struggle to acquire new oil and natural gas reserves in their attempt to withstand the commercial competition and to maximize their profit, whereas NOCs still lack the wider knowledge and experience that the IOCs possess and they still need more access to commercial markets, higher capital, and advanced technology practices.

Forming a partnership between IOCs and NOCs can overcome such challenges in a way that each party would be able to complete the demand of the other; to share their joint resources and to maximize their profits.

One of the forms of partnership is forming a strategic alliance between IOCs and NOCs, in which the two entities will share a codependent relationship in which NOCs will allow IOCs to use their gas and oil reserves and investment opportunities while IOCs will enable NOCs to benefit from their financial resources, technological advancement, project management capabilities, and their developed talent leverage. Strategic alliances are usually pursued to allow NOCs or IOCs to invade a new market, product or strategy that they don’t have the skills to manage on their own and to reduce the risks involved.

“In fast-moving markets alliances are becoming a norm as the level of conflict is minimized by partners recognizing that they are the only vehicle for minimizing risk associated with market and technology uncertainty,” quoted from Newman and Chaharbaghi’s, “Strategic Alliances in Fast-moving Markets,” Elsevier Science Ltd. The strategic alliance will enable NOCs of host governments to fulfill production and recovery goals while extracting the expected value from their hydrocarbon resources. Meanwhile, IOCs will receive a fair share of the rewards they deserve for their technical and financial contribution.

In a strategic alliance, governments, NOCs, IOCs and other stakeholders should work together to boost their cooperation and to understand the interdependent nature of the industry and its importance to the global economy.

Last February, at the International Petroleum Week hosted in London by the Energy Institute, Qatar’s Minister of Energy & Industry, Mohamed bin Saleh al-Sada told Bloomberg, when asked about the relationship between IOCs and NOCs in the middle-east: “NOCs have become more international. The gap between the two is narrowing and we are learning from and cooperating with each other. The partnership between the two is always there and there is competition around who will add more value to any new enterprise. Be it NOC or IOC you will always find that the strength of one can be merged into the strength of the other in a complementary way. I think that the cooperation between NOCs and IOCs will continue and IOCs will continue to add value but the choice is going to be wider in terms of who adds more value to specific projects.”

Elements of Building a Successful Strategic Alliance

There are many successful NOC-IOC strategic alliances that have strengthened and added value to the parties involved in it across the globe. We have witnessed the establishment of strategic alliances

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forming in the MENA region, Africa, Asia, North and South America, and Europe, in which a fruitful positive outcome resulted from the cooperation within many segments of the oil and gas industry like IOC and NOC sector. From monitoring and evaluating the past and present successful NOC-IOC strategic alliances, we can conclude that the following key elements should be considered in the process of building and maintaining a successful strategic alliance between the IOCs and NOCs.

Establishing a Long-Term and Sustainable Relationship

Strategic alliances are initially formed to gain mutual benefit between IOCs and NOCs and fulfill the gaps that each party can’t fulfill on its own. It is very important to ensure the longevity and sustainability of such alliances in order to maximize the profitability from such partnership for years to come. The relationship between IOCs and NOCs should depend on mutual respect, trust, and benefit.

Gaining trust and respect can be initially achieved through respecting the terms and the agreements of the contracts. To make sure that the mutual benefit from the alliance is gained, the two parties should understand that each alliance should operate not as two entities but as one and each party should work in favor of satisfying the business needs of the other.

It is essential to build relationships that will be strengthened and evolved over time and would be able to withstand the changing economic, social and technological circumstances. Before forming the alliance, the IOCs should study the home countries of the NOCs in which they would operate in regards to the political, economic, social conditions, and the nature of the workforce, to enable the two parties to coordinate on how they would address the challenges and take advantage of the up-sides.

IOCs and NOCs engaged in a strategic alliance should understand that they have become equal partners who share risks and profits accordingly. A change in the economic or political environment can bring new challenges that may result in a conflict between the two parties, understanding how to address the conflict with respect and flexibility through dialogue, re-negotiations or mediation will strengthen the relationship between IOCs and NOCs.

From their side, the NOCs should make sure that they coordinate with their local government in finding the best way they can aid and facilitate the IOCs investment in the home country, in a way that will enable them to achieve their goals from entering the strategic alliances with minimum barriers and to enable the two organizations to maximize their profit from the investment.

Maximizing Profit

The main purpose of forming a strategic alliance is to maximize the profit of the IOCs and NOCs involved, which can be initially achieved through mutual sharing of access to reserves from the NOCs side and the share of knowledge and experience from the IOCs side. Boosting the revenues of the two parties can be gained through other methods as well, like exploring new areas with the use of the shared capabilities of the two organizations in which the strategic alliance can look beyond the borders of one particular oil- producing country and form ventures in third countries where they can operate jointly, strengthening the concept of being equal partners who share the same risks and reaped the shared capabilities of the two organizations within the same sector can create a better chance for increasing revenues. For example, the strategic alliance can start working on new kinds of energy like nuclear and renewable energy through the usage of the joint forces of the partnership that may facilitate what would have been a much difficult area to invest in before the establishment of the alliance.

Investing in Human Capital Development

One of the biggest assets of any organization is the people working in it. Investing in human capital development once a strategic alliance is formed is a focal point when it comes to building a new successful entity. Understanding the workforce structure of the home country of the NOC and working on how to develop, train and educate the people of the organization is the most significant sustainable development that can affect the present and the future of the strategic alliance.

Since NOCs mainly enter the strategic alliance to gain from the knowledge and experience of the IOCs, the two parties should work together in developing training opportunities and education programs for the personnel to encourage them to move forward and reinforce the share of knowledge and experience.

IOCs and NOCs should cooperate on forming an industry- focused education and training initiatives, since developing a new talented generation of geological, geophysical, and engineering callbers is a must for energy companies seeking to extract oil and gas from challenging locations.

Investing in Research and Development

Investing in Research and Development (R&D) is the gate to the future growth of the strategic alliance. Establishing a strong cooperative R&D programs will aid in promoting innovation and creating new and improved technologies that will work in favor of the strategic alliance and will help the new entity in adapting to the changing and evolving climate that surrounds the oil and gas industry. Investment in R&D becomes easier once an alliance is formed since the high cost of such programs will be divided.

In the last years, companies who invested in R&D have gained economic rewards from the technology-driven strategies and the innovations they were able to form and execute. Plenty of IOCs and NOCs have increased their funding of their R&D programs over the past years. Specifically, oil-field service companies have expanded their investment in innovation.

Brazil is considered a successful example of R&D focus. Since the late 1990s, it has been investing billions of dollars in funding and supporting R&D programs in the oil-producing country. According to The Brazilian National Agency of Petroleum, the agency expects that within the next decade, more than $1 billion will be provided to support the expansion of the oil and gas industry in the country, with the aim of reaching $2 billion per year in 2017.

The Brazilian oil and gas company, Petrobras has been increasing its investment in R&D by 23% annually since the year 2003.

In 2014, GE Opened a Global R&D Center in Brazil to collaborate with Petrobras and BG Group to develop advanced technologies for the oil and gas sector within the country.

GE Chairman and CEO, Jeff Immelt, commented at the time: “Over the past decade, we have doubled down on our R&D investment and expanded our global network of Research Centers to address customer’s growing needs for breakthrough technology that we develop with them. We see significant growth opportunities in Latin America and having the best technology and solutions will ensure we maintain GE’s competitive edge.”

Focusing on Social Responsibility

The collaborating parties of the strategic alliance must understand the importance of respecting the community they will be operating in. Paying respect to the community can be achieved through respecting the local culture, the environment and the community’s expectations and goals. Social responsibility programs that will aid the community can build rapport between the organization and the local community.

The strategic alliances between NOCs and IOCs should also focus on developing their energy products in a way that would enhance the living conditions of the people living in such communities.

One of the social responsibility projects that resulted from the strategic alliance between ExxonMobil and Qatar petroleum is the “Qatar University ExxonMobil Teachers Academy.” The academy which was formed in collaboration with Qatar University and Exxon Mobil is an initiative aiming at enhancing the math and science education for elementary school children and boosting development, advancement, and innovation of their education system.

ExxonMobil developed this program to supply teachers with the necessary tools and strategies to create enthusiasm about math and science and to help them in educating and developing the next generation of scientists, engineers, and innovators.

Prioritizing the Safety and Environment Considerations

Environmental protection and operational safety should be considered as an essential priority of the working agenda of the strategic alliance. Following the global best practices of the safety and environmental protection standards can impact the building of the successful long-term partnership that is capable of meeting the expectations of the local communities of the hosting countries.

Due to their longer history as experienced oil and gas operators, the IOCs usually have larger exposure to safety and environmental protection regulations and cultures in different parts of the world, but they should not underestimate the NOC’s knowledge of the local cultural, environmental and reservoir conditions. They should always cooperate to find the best practices and solutions for recovering the most oil and gas from specific reservoirs, in particular countries in the safest and best manner that won’t harm the local environments and communities.

IOCs and NOCs should make sure that they are responsibly producing and consuming energy in order to satisfy their customer’s energy needs in a sustainable fashion that can be achieved through maintaining and strengthening the reliability and security of the energy supplies.

In conclusion, NOCs and IOCs engaged in a strategic alliance depend on each other to gain mutual benefit and complete the gap that each entity can’t fulfill on its own. Such collaboration between the IOCs and the NOCs which can develop new technologies that can improve their expertise, technological practices and their marketing channels to gain access to the resources owned by the NOCs, while NOCs can take advantage of the capabilities that the IOCs can offer while providing them with broader access to their home countries’ valuable resources and investment opportunities for them. Maintaining and enhancing such alliances can be achieved through building a strong, long-term and sustainable relationship where the two entities act as one, maximizing the profit of the newly formed alliance, investing in human capital development, and respecting the local communities’ expectations and goals. Such results on the long-term, engaging in social responsibility projects, and finally prioritizing the safety and environmental considerations in respect of the communities in which they operate in.